STATE OF MAINE
PUBLIC UTILITIES COMMISSION

August 20, 2004

ORDER

NORTHERN UTILITIES, INC.
Request for Approval of
Reorganization (NiSource/Columbia
Merger and Related Transactions)

Docket No. 2000-322

NORTHERN UTILITIES, INC.
Request for Approval of Reorganization –
Merger with NIPSCO Industries

Docket No. 1998-216

Welch, Chairman; Diamond and Reishus, Commissioners

I. SUMMARY

In this Order, we impose a penalty of $15,000 on Northern Utilities, Inc. (Northern or NU) for its failure to adhere to either of the approved post-merger corporate structures we approved in *Northern Utilities, Inc., Request for Approval of Reorganization – Merger with NIPSCO Industries,* Docket No. 1998-216.

II. OVERVIEW

A. Background

The merger involving NU and NiSource (NI) occurred on February 12, 1999 when NiSource acquired Bay State Gas Company (BSG), which was NU's parent at the time. We approved a stipulation allowing this transaction to proceed. *Northern Utilities, Inc., Request for Approval of Reorganization – Merger with NIPSCO Industries,* Docket No. 1998-216, Order Approving Stipulation and Merger (June 12, 1998).[1] The parties to the merger proposed two possible post-merger corporate structures, which envisioned NU as a direct subsidiary of either NI (in the so-called "Preferred Merger") or of NI's largest utility, Northern Indiana Public Service Company (the so-called "Alternate Merger"). Because the only post-merger structural change for NU was a change in its immediate parent, not the addition of another corporate layer above it, we concluded that the transaction would not greatly complicate our future oversight of NU. The Office of the Public Advocate (OPA) agreed to these structural parameters and our Order approved them as proposed and stipulated by the parties.

[1] The acquirer was known as NIPSCO Industries at the time. This entity later renamed itself NiSource, Inc. We refer to both in this Order with the abbreviation NI.

The merger parties subsequently decided to use a third alternative corporate structure, in which NU remained a subsidiary of BSG, which in turn became a subsidiary to NI, without notifying the parties to the prior stipulation and without requesting further Commission approval. This departure came to light only with the Company's subsequent request for approval of a second merger, this time between NU's parent NI and Columbia Energy Group. See *Northern Utilities, Inc., Request for Approval of Reorganization – NiSource Merger and Related Transactions,* Docket No. 2000-322, Order (June 30, 2000). In that docket, we directed Staff to investigate this matter further and to make a recommendation as to whether we should impose a penalty for failure to comply with our order in Docket No. 1998-216 and whether we should modify that Order.

B. Procedural History

In response to our directive, the Advisory Staff issued a Data Request to Northern on September 21, 2001 and Northern filed its responses on October 24, 2001. Staff reached the preliminary conclusion that NU's ratepayers were not harmed by the use of a different post-merger corporate structure. Two factors led to Staff's conclusion. First, NU had not had a rate case in many years and thus inter-affiliate expenses borne by ratepayers did not increase as a result of the merger. Second, NU subsequently proposed to modify the agreements governing charges for services provided between and among itself and affiliates in such a way as to essentially make it a direct subsidiary of NiSource, Inc. as originally envisioned in Docket No. 1998-216.

Staff chose to defer making a recommendation on a financial penalty until the revised affiliate agreements were either approved or rejected by the Commission. In January 2002, NU filed the first of these modified agreements in *Northern Utilities Request for Approval of Affiliated Interest Transaction with NiSource Corporate Services, Inc*., assigned Docket No. 2002-21, and we approved it on July 2, 2002. NU followed up in October 2002 with a related filing *Northern Utilities Request for Approval of Affiliated Interest Transaction with Bay State Gas Company*, assigned Docket No. 2002-614, and we approved this request on March 3, 2003.

On July 28, 2004, Staff issued an Examiner's Report in which it recommended that no penalty be imposed for NI and NU's actions because there was no evidence of harm to ratepayers. OPA filed exceptions to the Report, urging the Commission to impose a penalty of $50,400, representing $100 per day or one-tenth of the maximum per-day penalty, for Northern's failure to comply with its stipulated agreement made with the OPA and with a Commission order approving that agreement. OPA asserted that such conduct should have consequences, but that a harsh penalty was not warranted because no particular harm to ratepayers had been identified. Northern commented that there was never any intent to evade compliance but acknowledged its need to remain diligent on matters of regulatory compliance.

C. Record

The record of this proceeding shall consist of all orders, transcripts and documents (including data requests and responses) filed with the Commission in both Docket No. 1998-216 and Docket No. 2000-322.

III. DECISION

The parties to the merger stated that the decision to change the post-merger corporate structure when the NI/BSG merger closed was due to the existence of a potential capital gains tax liability in Massachusetts under either of the corporate structures we approved in Docket No. 1998-216. The merger parties estimated the potential tax liability was approximately $3.2 million to $3.6 million. The merger parties did not consult taxation authorities in Massachusetts directly or request a formal opinion on whether a taxable event would occur with this part of its reorganization but instead reached the conclusion following discussions with its tax advisors that a capital gains tax would likely apply. The merger parties ultimately decided not to proceed with the agreed upon post-merger corporate structure based on the assumption that a tax liability would result. Rather, they adopted an alternative structure in violation of our Order in Docket No. 1998-216. This alternative course was never discussed with the OPA, nor did the parties request that we modify our earlier Order in Docket No. 1998-216.

Simply put, the parties to the merger failed to recognize their regulatory obligations in Maine. Significantly, our Order approving the NIPSCO merger emphasized our concerns that the corporate structure be designed to allow Northern to remain separate and to maintain some control or influence over its own operations. We did so in an effort to protect Northern's ratepayers, recognizing that Northern would comprise a very small part of the NI corporate whole and that its interests might be overlooked. The handling of the merger only serves to demonstrate the validity of that concern and the need to make certain the Maine operations are not ignored in the future.

In hindsight, it seems reasonable to assume that a formal opinion by the Massachusetts taxation authority stating that a significant tax liability would have resulted from the corporate structure we approved would have provided the Commission sufficient justification to look favorably upon a requested change from the parties. In addition, we believe that combining such an opinion with a pledge to overhaul the agreements governing charges to NU from its corporate parents/affiliates, and perhaps a rate stay-out period until such agreements had been modified and operated for a period of time, would have made it easier for us to conclude at the time of the NIPSCO merger that the post-merger corporate structure would not have been adverse to the public interest. Instead, the parties took this step without seeking the required regulatory approval of the revised corporate structure decision.

Based on the preceding, the parties appear to have been negligent at best and indifferent to their obligations to the Commission at worst. We conclude that the decision not to adopt one of the approved corporate structures constituted a failure to obey a Commission order for which a penalty may be imposed under 35-A M.R.S.A. §1508. In addition, since the reorganization as implemented was never approved by the Commission, as required by 35-A M.R.S.A. §708, the parties might also be said to have violated a provision of Title 35-A for which a penalty may also be imposed under 35-A M.R.S.A. §1508.

Concluding that we may impose a penalty is not the same as concluding that we should. As Staff correctly observed, the absence of a finding of harm to Northern's ratepayers militates against imposing sanctions. On the other hand, a major benefit of the corporate structures approved in our earlier order is that they would tend to force management to pay attention to the interests of Maine ratepayers and the requirements of Maine law, even though only a small percentage of the new entity's business is in Maine. By ignoring that Order, however, the parties have made it necessary for us to send a somewhat stronger message. This becomes particularly important now that our major gas and electric utilities have been subsumed into larger entities with substantial operations in other states.

We have explored the range of penalties that we can impose based on 35-A M.R.S.A §§1504 and 1508, as they read at the time of the offense. Pursuant to section 1504, each day that a party fails to comply with a Commission order constitutes a separate offense. Section 1508 states that a utility that violates a provision of Title 35-A or fails or refuses to obey a Commission order has committed a civil violation for which a forfeiture not to exceed $1,000 may be assessed for each offense. The Company was in violation of our Order in Docket No. 1998-216, and of 35-A M.R.S.A. §708, for 504 days -- from the closing date of the original NI/BSG merger, February 12, 1999 (per NiSource 1999 Annual Report to Shareholders at 42), to June 30, 2000, the date of our Order in Docket No. 2000-322 in which we approved the revised corporate structure. We conclude that we can assess a maximum penalty of $504,000 if we apply the maximum penalty of $1,000 per day for 504 days.

Because we found no evidence that there was harm to ratepayers, we will impose a modest penalty of $15,000. We note that, following our discovery of the merger parties' non-compliance, Northern acted conscientiously to file the necessary service agreements and resolve other details of the merger. Having worked with Northern's current management for many months now since this matter arose, we believe that the Company's current local management does appreciate that regulatory compliance in every jurisdiction is essential, even if the local entity, e.g. Northern - Maine, constitutes only a small part of the larger entity. Given that the larger entity, rather than simply local management, was involved in this non-compliance, this penalty should serve as a reminder to NiSource, as well as Northern, that similar omissions in the future may lead to the imposition of more substantial financial penalties.

IV. CONCLUSION

Accordingly, we impose a financial penalty on Northern of $15,000 for its failure to comply with our June12, 1998 Order approving the Stipulation in *Northern Utilities, Inc., Request for Approval of Reorganization – Merger with NIPSCO Industries,* Docket No. 1998-216, for the reasons specified herein.

Dated at Augusta, Maine, this 20th day of August, 2004.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Diamond
Reishus

COMMISSIONER ABSENT: Welch

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within **21 days** of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.